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No. 82-734

In the Supreme Court of the United States

OCTOBER TERM, 1982

TIRSO DEL JUNCO, ET AL., PETITIONERS

v.

C. T. CONOVER, COMPTROLLER OF THE CURRENCY, DEPARTMENT OF THE TREASURY

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the Comptroller of the Currency's determination that petitioners, directors of a national bank, knowingly approved loans in excess of the bank's legal lending limit is supported by substantial evidence.

2. Whether the Comptroller of the Currency exceeded his statutory authority by ordering directors to indemnify a national bank for the entire amount of illegal loans, without any reduction reflecting recoveries by the bank against the debtor, except insofar as those recoveries exceed the amount of an earlier, lawful, loan to the debtor that remains outstanding.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-12) is reported at 682 F.2d 1338. The decision of the Comptroller of the Currency (Pet. App. 33-52), the accompanying Order to Cease and Desist (Pet. App. 53-55), and the Opinion and Recommended Decision of the Administrative Law Judge (Pet. App. 13-32) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on July 30, 1982. The petition for a writ of certiorari was filed on October 28, 1982. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The pertinent facts are fully stated in the decision of the Comptroller of the Currency (Pet. App. 34-40) and are summarized in the court of appeals' opinion (*id.* at 1-4). Briefly, petitioners are the directors of the Los Angeles National Bank ("the Bank"). On two separate occasions petitioners, having full knowledge of all relevant facts, approved the making of loans in excess of the Bank's lending limit established by 12 U.S.C. 84.[1] On January 19, 1979, the Bank made an unsecured loan of $225,000 to Rehbock Lewis, president of Fame Furniture, Inc. ("Fame"). Petitioners knew that the proceeds of this loan were to be used for the benefit of Fame. Four months later, the Bank made a second loan of $225,000, this time directly to Fame. Fame's aggre-

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[1] As of the date of the transactions in controversy, 12 U.S.C. 84 provided in pertinent part:

> The total obligations to any national banking association of any person, copartnership, association, or corporation shall at no time exceed 10 per centum of the amount of the capital stock of such association actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund.

Section 84 has recently been amended to increase the lending limit established to 15% of the capital base, and to allow extension of additional credit in an amount up to 10% of the capital base where that amount is properly collateralized. Pub. L. No. 97-320, Section 401(a), 96 Stat. 1508.

gate line of credit based upon the two loans was more than $177,000 over the legal limit. Yet, one month later, the Bank made a third loan, in the amount of $125,000, to Ralph Ware, treasurer of Fame, which petitioners knew was for the benefit of Fame. The final loan was sought because Fame's checking account with another bank was overdrawn. The loan was made in Ware's name because the Bank's lending officer advised Lewis and Ware that an additional loan to Lewis or Fame would be unlawful. The Bank's lending officer acknowledged that he knew the proceeds of the loan to Lewis would be used for the benefit of Fame, and in fact the proceeds were deposited directly into Fame's corporate checking account. When the third loan was extended the Bank's loans for the benefit of Fame aggregated more than double the sum permitted by law.

2. The foregoing transactions and apparent violations of 12 U.S.C. 84 were uncovered during a routine periodic examination of the Bank by the Comptroller of the Currency. The Comptroller initially requested that the Bank directors who approved the loans in excess of the Section 84 limit indemnify the Bank for any losses resulting therefrom. Upon the directors' refusal to comply, the Comptroller initiated a formal administrative cease and desist proceeding pursuant to 12 U.S.C. (Supp. V) 1818(b). Petitioners acknowledged in the pleadings that the proceeds of the loan to Lewis were for the benefit of Fame. The administrative law judge accordingly ruled that the Lewis and Fame loans were to be aggregated for purposes of 12 U.S.C. 84, see 12 C.F.R. 7.1310(c)(3), and that the latter loan accordingly had been made unlawfully. After an evidentiary hearing disclosing the circumstances in which the loan to Ware had been made, the ALJ made a similar determination respecting that loan.

The Comptroller adopted the ALJ's findings respecting the unlawful extensions of credit (Pet. App. 34-40). The Comptroller observed that because the cease and desist order based upon a violation of 12 U.S.C. 84 was sought through administrative proceedings under 12 U.S.C. (Supp. V) 1818(b), rather than in district court pursuant to 12 U.S.C. (Supp. V) 93, it was not necessary to establish a "knowing" violation of Section 84, as is required under Section 93. The Comptroller added, however, that if such a showing were necessary, it had been made, because the petitioners knew the amount of the various loans, knew that each loan was made for the use of Fame, and knew that the loans, if aggregated, exceeded the Bank's loan limits (Pet. App. 39-41)

In framing a remedial order pursuant to 12 U.S.C. (Supp. V) 1818(b)(1),[2] the Comptroller concluded that no part of the funds recovered on the unlawful loans by the Bank should be applied to reduce the liability of the directors until the earlier lawful loan to Lewis for the benefit of Fame had been satisfied (Pet. App. 41-49). The ALJ had recommended that the proceeds of the sale of bonds owned by Lewis that had been pledged to secure the illegal loan to Ware, and a balance in Fame's checking account with the Bank, be set off against the directors' liabil-

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[2] 12 U.S.C. (Supp. V) 1818(b)(1) provides in pertinent part that when the record of the administrative proceeding establishes a violation of any banking law or regulation, the banking regulatory agency vested with jurisdiction may issue an order

> requir[ing] the bank or its directors, officers, employees, agents, and other persons participating in the conduct of the affairs of such bank to cease and desist from the same, and, further, to take affirmative action to correct the conditions resulting from any such violation * * *.

ities on the Ware and Fame loans (*id.* at 25-28).[3] The Comptroller rejected this portion of the ALJ's recommendation, noting (*id.* at 43) that the fiduciary relationship between the Bank and its directors, the subject of this proceeding, was not governed by the rules applicable to the contractual relationship between the Bank and its borrowers (compare note 3, *supra*).[4] The Comptroller observed that 12 U.S.C. (Supp. V) 1818(b)(1) authorizes him to require "affirmative action [by directors] to correct the conditions resulting" from unlawful banking practices, and that the "conditions" resulting from the illegal loans in this case include all of the injurious consequences to the Bank of the illegal loans (Pet. App. 41). By making the illegal loans to Fame and Ware for the benefit of Fame, the Comptroller stated, petitioners not only subjected the Bank to risk of loss on those loans, but, as a practical matter, substantially undercut the security of the earlier legal loan to Lewis for the benefit of his company (*id.* at 46-48). Accordingly, the Comptroller deemed it appropriate

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[3] As between the Bank and the borrowers these assets had been applied to repay the Ware loan in its entirety and to reduce the outstanding balance on the Fame loan. The ALJ stated that the bonds and checking account proceeds could not be applied by the Bank to discharge the loan to Lewis, and reasoned that the directors' liabilities to the Bank accordingly had to be reduced to reflect the partial payment of the illegal loans (Pet. App. 26-28).

[4] The Comptroller assumed that the ALJ was correct in suggesting (see note 3, *supra*) that as between the Bank and its borrowers Fame's corporate checking account balance could be applied only against the illegal Fame loan, and the proceeds of the sale of Lewis' bonds pledged as collateral for the Ware loan had to be applied first to discharge that loan (Pet. App. 43).

to apply recoveries from the borrowers to reduce petitioners' liabilities only to the extent that they exceeded the amount due on the initial lawful loan to Lewis. The Comptroller explained (Pet. App. 48-49; citations omitted):

> This approach avoids promoting a conflict between the Directors' fiduciary duty and the best interest of the Bank, since the Board is encouraged to maximize recoveries on an excessive line of credit without regard to whether a particular recovery would be applied to a legal or illegal loan. This approach also avoids rewarding the Directors for their dilatory tactics in refusing to make the Bank whole and is consistent with national bank director responsibilities generally.

The Comptroller rejected petitioners' contention that the remedy prescribed was contrary to certain language in *Corsicana National Bank* v. *Johnson*, 251 U.S. 68, 87 (1919), which, petitioners claimed, required that the Bank's recoveries on the illegal loans be applied to reduce their liabilities in respect of those loans. The Comptroller remarked (Pet. App. 44 n.5):

> While it is true that the court observed, at 251 U.S. 87, that "whatever of value the Bank recovered from the borrowers on account of the loan would go in diminution of damages . . .," the observation related to a single loan, not to a series of loans with the first credit extension being legal. In other words, this case did not address the question of whether recoveries should be applied to reduce directors' liability on an excessive loan while an earlier, lawful loan to the same borrowers remains unpaid.

Although petitioners were potentially liable for the entire amount of the two unlawful loans ($350,000, plus interest due thereon), see *Corsicana National Bank* v. *Johnson*, *supra*, they were actually held liable only for the difference between their total potential liability and the amount recovered by the Bank in excess of the amount due on the initial lawful loan to Lewis (Pet. App. 49). To ensure that petitioners received the benefit of any additional recoveries on the outstanding balance due to the Bank, the Comptroller directed that, upon payment by petitioners of the indemnity required by his order, the Bank was to transfer its interest in the Fame-related loans to petitioners (*id.* at 51, 55).

3. The court of appeals affirmed the Comptroller's decision and upheld the remedial order (Pet. App. 1-12). The court initially held (*id.* at 5-6) that the Comptroller's findings that all of the loans were made for the benefit of Fame (and thus were to be aggregated for purposes of 12 U.S.C. 84) were supported by substantial evidence. The court assumed arguendo that a prerequisite to entry of a remedial order under 12 U.S.C. (Supp. V) 1818(b) is establishment of a "knowing" violation of 12 U.S.C. 84, such as is required in an action in district court under 12 U.S.C. (Supp. V) 93. The court concluded that any scienter requirement had been satisfied, however, because petitioners were shown to have "knowledge of the identity of the borrowers, knowledge that all the loan proceeds were to be used by one company, and knowledge of the loan amounts and the bank's loan limits" (Pet. App. 8).

The court of appeals also upheld the Comptroller's remedial order, rejecting petitioners' argument that the recoveries applied to the illegal loans by the Bank

must be similarly applied to reduce their liabilities to the Bank (Pet. App. 9-11). Underscoring the Comptroller's broad discretion under 12 U.S.C. (Supp. V) 1818(b) to fashion an appropriate remedy, the court of appeals noted that the policy of 12 U.S.C. 84—protection of a bank's assets—would be frustrated if directors were permitted to escape liability for risk of loss imposed upon a bank when directors make lawful unsecured loans to a borrower, followed by further unlawful extensions of credit secured by the borrower's assets. The court explained that "relief" tailored in the manner suggested by petitioners (Pet. App. 10):

> would permit the Directors to protect themselves fully against any exposure resulting from the illegal loans while substantially increasing the risk that the bank would be unable to recover the amount of its legal loan. The fiduciary responsibility of the Directors of the bank precludes them from protecting themselves against liability at the bank's expense. * * * Thus, the Directors may not use the borrower's assets to extinguish their own liability to the bank.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or of any other court of appeals. The opinions of the court of appeals and the Comptroller of the Currency, upon which we rely, fully and persuasively answer the contentions advanced in the petition. Further review of the decision in this case is accordingly unwarranted.

1. Petitioners initially contend that the decision of the court of appeals is at odds with decisions of this Court (*Corsicana National Bank* v. *Johnson*,

supra, 251 U.S. at 71-72; *Yates* v. *Jones National Bank*, 206 U.S. 158, 178, 180 (1907)) holding that a knowing violation of the credit limits established by 12 U.S.C. 84 must be proven in an action under 12 U.S.C. (Supp. V) 93 to recover damages from a national bank director. But, as the court of appeals observed (Pet. App. 7), the liabilities imposed upon petitioners do not rest upon Section 93, derived from the National Bank Act of 1864, which on its face applies only to knowing violations, but upon provisions of 12 U.S.C. (Supp. V) 1818(b)(1), enacted in 1966 and supplemented in 1978, that do not require any such showing. Without qualification Section 1818(b)(1) allows the Comptroller to require "affirmative action to correct the conditions resulting from" any banking law violation. See page 4 note 2, *supra*. Accordingly, petitioners' reliance upon cases construing Section 93 is entirely misplaced. Significantly, petitioners do not, and cannot, claim that the court of appeals' decision conflicts with any decision of this Court or of any other court respecting 12 U.S.C. (Supp. V) 1818(b)(1).

In any event, the court of appeals, the Comptroller, and the ALJ all correctly determined that, if applicable, the scienter requirement of Section 93 was satisfied in this case (see Pet. App. 7-9, 23-25, 40-41). The court of appeals concluded (*id.* at 5-6, 8) that substantial evidence supported the Comptroller's determination that petitioners had knowledge of all pertinent facts establishing a violation of 12 U.S.C. 84—the identity of the borrowers, the intended use of all three loans for the benefit of one borrower, the amounts of the loans, and the Bank's loan limits.[5]

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[5] Petitioners mischaracterize the court of appeals' decision as holding that "[p]etitioners intentionally violated Section

Petitioners' contrary assertion (Pet. 9) impermissibly asks this Court to re-examine the court of appeals' assessment of the substantial evidence question. *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 310 (1974); *Universal Camera Corp.* v. *NLRB*, 340 U.S. 474, 491 (1951).

Moreover, petitioners have identified no evidence to support their assertion.[6] Given the findings of the Comptroller upheld by the court of appeals, petitioners' explanation that "at the time they approved each loan [they] believed [that] the loans did not exceed the lending limits of the bank" (Pet. 8) is unavailing. Because petitioners were found to have had knowledge of all the facts establishing a violation of 12 U.S.C. 84, petitioners' contention must be understood as either ignorance of the law or a failure to appreciate the significance of the facts known to them. Neither theory affords any recognized defense to petitioners.

2. Petitioners also contend (Pet. 9-13) that the Comptroller's remedial order, prohibiting application of the borrowers' assets to reduce petitioners' liability upon the unlawful loans until recoveries from the borrowers exceed the amount due to the Bank on the initial unsecured but lawful loan to Lewis, is inconsistent with *Corsicana National Bank* v. *Johnson*,

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84" (Pet. 5; see also Pet. 7). As described above, the court of appeals actually concluded that substantial evidence supported the Comptroller's findings of knowing violations (Pet. App. 7-9). As early as *Thomas* v. *Taylor*, 224 U.S. 73, 82 (1912), this Court rejected the view that director liability under 12 U.S.C. (Supp. V) 93 must rest upon a finding of an intentional violation.

[6] Indeed, petitioners' own answer to the Comptroller's notice of charges (see Pet. App. 36-38) provides substantial evidence supporting the Comptroller's findings.

supra, 251 U.S. at 87. But, as the opinion of the Comptroller explains (see Pet. App. 44 & n.5), *Corsicana National Bank* simply does not address the situation presented here (see page 6, *supra*).

In addition, as we have noted, *Corsicana National Bank* sheds no light upon the proper interpretation of the Comptroller's subsequently enacted authority under 12 U.S.C. (Supp. V) 1818(b)(1) to shape an appropriate remedial order. As the court of appeals observed (Pet. App. 10), this grant of authority is broad and unqualified. Petitioners have not attempted to identify any error in the Comptroller's determination, endorsed by the court of appeals, that in the circumstances of this case, a remedial order tailored as petitioners suggest would not meet the statutory standard; that is, such an order would not "correct the conditions" resulting from petitioners' unlawful extension of credit. See 12 U.S.C. (Supp. V) 1818(b)(1).[7]

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[7] We note that the Comptroller's apprehension that the Bank might suffer unless petitioners were held accountable for their maladministration of the Bank's assets is not at all speculative upon the facts of this case, because the corporate borrower, Fame, entered bankruptcy shortly after the loans in question here were made (see Pet. App. 48). Indeed, even at the time the final loan of the series at issue was made to Ware, Fame's checking account with another bank was overdrawn (Pet. App. 5). Of course, should the borrowers ultimately make good upon all their debts, petitioners, who stand in the shoes of the Bank under the Comptroller's remedial order, will suffer no loss.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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